Executive Compensation Law

ALERT

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Executive Compensation after the American Jobs Creation Act

The American Jobs Creation Act of 2004 (the "Jobs Act") has radically changed the world of nonqualified deferred compensation in particular and executive compensation in general. The Jobs Act has created a new starting place for structuring nonqualified deferral and retirement plans but has not necessarily reduced their use or flexibility. In fact, as we begin to understand the new rules more fully, we discover new opportunities for providing executives and employers with desired objectives. Notably, the Jobs Act also impacts many other types of executive compensation arrangements such as employment agreements and equity, incentive, severance and even some welfare benefit plans in often counterintuitive ways that will continue to plague employers and executives for some time. This article first addresses the application of the new rules to traditional deferred compensation and retirement plans and then addresses other types of compensation arrangements.

Application of New Legislation Generally

The American Jobs Creation Act of 2004 creates a new section in the Internal Revenue Code that specifically deals with deferred compensation plans. This Section, 409A, applies to any "plan," "agreement," or "arrangement" that provides for deferral of compensation, other than tax-qualified plans and tax-deferred annuities, IRAs, SEPs, SIMPLEs, 457(b) plans, and plans providing for vacation, sick leave, disability, compensatory time, and death payments. Section 409A is not limited to elective non-qualified deferred compensation arrangements but also applies to nonelective supplemental executive retirement plans (SERPs), bonus plans, employment contracts, incentive plans, equity plans and other arrangements that provide for deferred payments as interpreted by the regulations.

Arrangements for employees, directors and independent contractors (unless they are providing substantial services to more than one unrelated employer) are subject to the new rules. Final regulations provide that independent contractors providing no more than 70% of their services (other than management services) to a single employer group are not subject to Section 409A and include a three year safe harbor look-back.

The new rules establish three new sets of constructive receipt rules. These rules are in addition to all existing rules. In other words, all of the existing rules regarding constructive receipt, economic benefit and assignment of income continue to apply.

Written Plan Requirement

Plans to which the new rules apply must be in writing on or before December 31, 2009 and must specify (1) the amount of the payment or the formula on which the determination of the amount shall be based, (2) the payment schedule or triggering events that will determine the timing of payments, (3) the six-month delay requirement applicable to severance payments made by public companies to specified key employees, and (4) for voluntary deferral plans, the conditions under which deferral elections must be made. In addition there are several presumptions in the final regulations which may be changed by specifica-

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tion of the desired treatment in the plan document. Final regulations provide that a savings clause will not work to provide a required provision or modify a noncompliance provision, however, recently released guidance regarding documentary corrections suggests that a general provision that requires all terms and provisions of a plan to be interpreted in compliance with Section 409A can be useful to prevent violations resulting from unclear language or application. Finally, the term "plan" is defined under the new rules to apply on a participant-by-participant basis to all arrangements of the same type between the participant and the company. Thus, for example, all voluntary deferral account balances between an employee and an employer under any arrangement are aggregated and treated as one plan. The advantage of this rule is that if the rules are violated for one employee, the benefits of all employees are not subject to excise taxes. The disadvantage is that if the rules are violated with respect to one arrangement for a particular employee, all arrangements of the same type for the same employee may be in violation. The categories of plans include voluntary account balance, non-voluntary account balance, defined benefit, involuntary severance/window programs, equity, split-dollar, reimbursement/in-kind benefit and foreign plans.

Deferral Elections

The new rules address the timing of elections to defer income. These rules are similar to the rules that have historically been used by the IRS as safe harbors for constructive receipt except that they focus on when "services are performed" rather than on when amounts are "earned." Amounts that are deferred will not be taxed until received if the election to defer is made no later than the end of the calendar year preceding the year in which services are performed. The IRS safe harbor rule allowing elections within 30 days of the participant first becoming eligible to participate in the deferred compensation plan has been retained in the new provisions as long as the participant is not already a participant in another voluntary deferral plan sponsored by the company.

There is also an exception for the deferral of amounts meeting the future regulatory definition of "performance bonus." A performance bonus must be payable over at least 12 months and based on parameters established within the first 90 days of the performance period. Under such circumstances, the election to defer the bonus may be made as late as six months before the end of the performance period. Final regulations include a definition of "performance based compensation" which requires that the bonus be "contingent on the satisfaction of organizational or individual performance criteria" which are not "substantially certain to be met at the time of the election." Bonuses may include subjective criteria relating to the performance of the participant or a group of participants, but the determination of such subjective criteria must not be made by the participant or a family member. The performance compensation does not include any amount that would be paid regardless of performance or based on a level of performance substantially certain to be achieved at the time the criteria is established. Also, performance cannot be simply based on an increase in stock value.

Thus, the new rules follow prior timing of election principles fairly closely but clarify the required timing for bonus deferral elections, which has historically been a very fuzzy area of the law. The new rules codify what was previously the conservative interpretation of the law but implement a new compromise allowing midyear deferrals for performance based bonuses. As a result, the new definition of performance based compensation is likely to impact the structure and administration of bonus plans.

Distribution Elections

The new distribution rules say that compensation or benefits that have been deferred may not be distributed any earlier than the occurrence of any of the following events:

1. Separation from service (<u>except that top employees of public companies must wait six months after separation from service</u>);

2. Disability of the participant:

   For purposes of the statute, a participant is disabled if he (1) is unable to engage in any substantial gainful activity by reason of any medically determined physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, or (2) is, by reason of any medically determinable physical or mental impairment that can be expected to result in death or can be expected to last for a continuous period of not less than 12 months, receiving income replacement benefits for a period of not less than three

months under an accident and health policy covering employees of the employer;

3. Death;

4. A specified time (or fixed schedule) designated at the date of the deferral, but not at an event, but may be at time of vesting;

5. A change in ownership or effective control of the employer, or in the ownership of a substantial portion of the assets of the employer as provided by regulations:

   Final regulations allow acceleration of payments on a "change in control" of the employer (or parent entity) and briefly include (i) a 50% change of ownership, (ii) a 30% change in voting over a 12 month period, (iii) a 40% sale of assets, or (iv) a 50% change in the board of directors over a 12 month period. Acceleration may be automatic under the terms of the plan or by employee election at time of deferral but employee may not be given discretion to elect to accelerate distribution at or around the time of the change in control without compliance with the normal change rules which require that the election be made 12 months in advance and delay commencement by at least five years. The change rules provide little flexibility unless the initial election provides for a delayed payment after change in control (e.g., 15 months) which gives the employee the time to make a change election to delay distribution by at least five years after the change in control occurs.

6. The occurrence of an unforeseeable emergency;

   For purposes of the statute, unforeseeable emergency is defined as a severe financial hardship to the participant resulting from an illness or accident of the participant, the participant's spouse, the participant's dependent (as defined in Code Section 152(a)) or the participant's beneficiary, loss of the participant's property due to casualty, or other similar extraordinary and unforeseeable circumstances arising as a result of events beyond the control of the participant.

Changes in Distribution Elections

Distribution elections may not be accelerated under any circumstances except as discussed in the next paragraph. A plan may permit participants to change distribution elections to further delay a payment or change the form of a payment, as long as (1) the election does not take effect until at least 12 months after the date on which the election is made, (2) if the election relates to a distribution to be made on separation from service, a specified time or a change of control, then the payment with respect to which the election is made must be deferred for a period of at least five years from the date the payment would have otherwise been made, and (3) if the election relates to a specified time, then it must be made at least 12 months before the date of the first scheduled payment.

Acceleration of the time or schedule of any payment of benefits is not permitted unless such an acceleration is permitted by the IRS in regulations. This wording is intended to prevent any type of acceleration, including the use of what have been called "haircut" provisions. A "haircut" is the imposition of a substantial penalty (for example, 10% of the benefit amount) formerly imposed on any acceleration of a distribution. The inclusion of a haircut was based on the premise that the penalty would be sufficient to prevent constructive receipt and taxation of the benefit. This new provision eliminates haircuts and other similar techniques. The new legislation limits not only the employee but also the employer from accelerating distributions under the plan. Thus, plans will no longer be able to allow employers the discretion to accelerate distributions even on termination or restructure a plan except under limited circumstances. Final regulations include the following exceptions:

— Termination of all plans of same type, may only liquidate after 12 month wait and within 24 months, can't adopt new plan for three years;

— Termination of plan on change in control, must apply to all participants alike and meet timing requirements – termination within 12 months of change in control and liquidation within 12 months of termination

— Termination of plan on liquidation of company or pursuant to bankruptcy;

— Accelerations under Domestic Relations Order – Note, need not be "Qualified" Domestic Relations Order;

— Distributions necessary to pay taxes;

— Distributions of minimal amounts to cash employee out of plan at employer discretion if less than 402(g) limit or acceleration of installment payments when present value falls below a specified amount.

Application of New Distribution Rules to Deferred Compensation Plans

The new distribution and change in distribution rules have had the most dramatic effect on the design and structure of nonqualified deferred compensation and retirement plans. Under prior law, participants were generally allowed to change at least the form, and often the commencement date, of retirement benefits up to one year prior to termination of employment. Under the new rules, distributions conditioned on retirement or termination of employment must be elected at the time of the original deferral election and may generally not be changed (even well in advance of retirement) without delaying commencement of the benefits at least five years beyond the date of retirement or termination. Because retirees and employers will rarely want to delay commencement of benefits until five years after retirement, this limitation effectively prohibits changes to retirement distributions. However, the flexibility lost in retirement elections may be made up to a significant extent by creative use of scheduled date distributions.

Under prior law, scheduled date or in-service distributions were available but conservative advisors did not allow or severely limited the ability to change such distributions. Also, plans generally allowed only one or two scheduled distributions and generally required funds to be paid out in a lump sum or over a fairly short period of time. The new rules specifically allow the change of scheduled distributions (as long as such changes meet the specified change rules) and do not limit the number of scheduled date elections or changes to such elections which a participant may make either before or after retirement. Thus, a participant who does not know the form in which she would like to receive her retirement benefits need only select a scheduled distribution date at least five years in advance of the year in which she wants to begin receiving benefits. Then, one year before such scheduled distribution, the participant can make a change election and specify any time and form of payout allowed under the plan as long as commencement is delayed by at least five years. If an employer is willing to offer participants maximum flexibility, a participant might establish five scheduled distribution dates in consecutive plan years and then have the ability beginning one year before the first scheduled date to annually decide how much of the amount elected for distribution in the following year to receive and how much to roll another five years or more.

The proposed regulations create additional flexibility by providing that plans may allow separate distribution elections for specified payments, accounts or categories of funds as specified in the plan document and change elections may apply separately to each category and even to individual installments if the plan so provides.

The new rules no longer allow unscheduled withdrawal or "call" provisions which previously allowed participants to take unscheduled distributions by payment of a penalty. However, the election of early scheduled distribution dates for multiple accounts which can be rolled forward in five year increments allows flexibility to take deferrals out early if it becomes desirable or advisable to do so without penalty.

Thus, while the new rules dramatically change the form which distribution elections may take going forward, they do not necessarily reduce the amount of flexibility which may be provided to participants in connection with the timing of distributions. However, the clear disadvantage of the new rules is the difficulty in communication and administration of such complex alternatives.

Funding Rules

There are two funding rules. The first rule precludes the use of off-shore securitization trusts. An exception is provided if substantially all the services to which the nonqualified deferred compensation relates are performed outside of the jurisdiction. The second rule precludes certain types of financial triggers that are intended to protect the executive in the event of the employer's financial difficulty. Thus, assets cannot be dispersed to a participant based on advance knowledge of changes in a company's financial health. These financial triggers do not include traditional concepts of change in control. Recent pension legislation has added additional limitation to Section 409A on informal funding of nonqualified plans for public companies with under-funded defined benefit plans.

Penalties

Under the new statutory constructive receipt rules there are onerous penalties for failure to comply. If a plan fails to meet all of the requirements of the rules or does not operate according to the rules, all the compensation for the taxable year and all preceding years is includible in gross income for the taxable year if it is not subject to a substantial risk of forfeiture. Additionally, the taxable amount is increased by interest for the entire time the plan is not in compliance and an excise tax of 20% is then added. The IRS has indicated that these penalties will be imposed individual by individual, so every participant will not be affected by the violation of one participant. The most significant impact of these severe penalties is likely to be the chilling effect on creative plan design. The Service has now issued correction procedures which provide a limited ability to correct administrative failures and documentary failures. Certain documentary failures may still be corrected without penalty by December 31, 2010.

Reporting and Withholding

The new statutory rules establish new reporting requirements for deferred compensation and withholding requirements for any amounts includible in gross income as a result of new Section 409A. Thus, the deferred compensation amounts will be required to be reported on Form W-2 and Form 1099 when deferred, even though they are not yet taxable. However, as deferred compensation is already reported for social security tax purposes, this should not be an onerous additional requirement. Implementation of the new reporting requirements has been delayed until further guidance is released.

Effective Dates and Transition Rules

The new rules are effective and apply to amounts "deferred" after December 31, 2004. (Earnings on amounts that are grandfathered are also grandfathered and not treated as additional deferrals). However, if plans are "materially modified" after October 3, 2004, (unless the modification is acceptable under IRS guidance), then the grandfather treatment is lost and the amounts are subject to the new rules of Section 409A. Final regulations provide transition rules which gave employers until December 31, 2009, to bring plans into compliance with the new rules. Recent correction procedures include a limited ability to correct noncompliant plan documents in certain respects prior to December 31, 2010. Thus, if plans have not previously been reviewed for 409A compliance, it is important that they be reviewed in 2010 to avoid penalties where possible.

Grandfathering Rules

The new rules apply to amounts vested or deferred in taxable years beginning after December 31, 2004. With respect to amounts earned in 2004 and payable in 2005, the guidance provides that such amounts will be considered deferred before January 1, 2005, if, by December 31, 2004, (1) the participant has a legally binding right to be paid the amount and (2) the right to the amount is earned and vested.

The guidance provides that it is not a "material modification" for a participant to exercise discretion over the time and manner of payment of a benefit to the extent such discretion is provided under the terms of the plan as of October 3, 2004. Thus, "call" or "haircut" acceleration provisions should still work in a grandfathered plan. Also, it is not a material modification to change a notional investment measure to, or to add, an investment measure that qualifies as a predetermined actual investment within the meaning of social security tax regulations. The amendment of a plan to bring the plan into compliance with the provisions of Section 409A will not be treated as a material modification.

Application to Other Kinds of Executive Compensation

As indicated in the introduction, these new rules are broad-based and determine the types of plans to which Section 409A will apply. As defined in the statute, Section 409A applies to plans other than qualified plans and bona fide vacation leave, sick leave, compensatory time, disability pay or death benefit plans that have the effect of deferring compensation. For purposes of this definition, the term "qualified plan" includes typical profit sharing and pension plans qualified under Section 401(a), tax-deferred annuities, SEPs, SIMPLES, Section 403(b), Section 423 and eligible deferred compensation plans under Section 457(b) (but not ineligible plans under Section 457(f)).

Short Term Payments Not Deferred Compensation

The regulations provide that the new rules are not intended to apply to bonus plans or other compensation arrangements where compensation is paid within two and a

half months after the close of the later of the taxable year or the employee or the employer in which the right to the compensation is earned and vested (the "Short Payment Period"). However, to the extent that a compensation arrangement provides for payments beyond this period, it will be subject to the new rules. Final regulations provide that if the arrangement does not specify the timing of the payments and payments are in fact made within the Short Payment Period, the payments will not be treated as deferred compensation subject to Section 409A. However, if payments are not made within the Short Payment Period they will be subject to Section 409A and may, therefore, have failed to comply with the requirements and be subject to an excise tax. Thus, it is important that all compensation arrangements now specify the timing of all payments in order to avoid the inadvertent application of Section 409A.

Definition of Substantial Risk of Forfeiture

The Short Payment Period discussed above commences upon the "vesting" of the right to the payment. Vesting occurs when a payment is no longer subject to a "substantial risk of forfeiture." The proposed regulations include a new definition of "substantial risk of forfeiture" and provide that compensation is subject to a substantial risk of forfeiture if entitlement to the amount is conditioned on the performance of substantial future services by any person or the occurrence of a condition related to a purpose of the compensation, and the possibility of forfeiture is substantial. Interestingly, the new rules provide that substantial risks of forfeiture added after the beginning of the service period to which the compensation relates are disregarded for purposes of determining whether the compensation is subject to a substantial risk of forfeiture (i.e., rolling risks of forfeiture will not work). In addition, unlike the substantial risk of forfeiture standard that applies under Section 83, an amount is not subject to a substantial risk of forfeiture under Section 409A merely because the right to the amount is conditioned, directly or indirectly, upon the refraining from performance of services. Thus, non-competes will not constitute a substantial risk of forfeiture under the Section 409A definition.

Proposed regulations also provide that an amount will not be considered subject to a substantial risk of forfeiture beyond the date or time at which the recipient otherwise could have elected to receive the amount of compensation, unless the amount subject to a substantial risk of forfeiture (ignoring earnings) is materially greater than the amount the recipient could have elected to receive. As a result, a salary deferral generally may not be made subject to a substantial risk of forfeiture. Final regulations clarify that amounts that may be paid on termination "for good reason" as defined by the regulations are subject to a substantial risk of forfeiture. Good reason is defined under the regulations to include material changes such as diminution in base compensation, authority, duties, title, budget, change in work location, or material breach of contract terms. The regulations include a safe harbor which requires the employee to notify the employer of the good reason condition within 90 days of the occurrence and to give the employer at least 30 days to cure.

Bonus Plans

Section 409A should not apply to annual bonus plans to the extent that bonus payments are made within the Short Payment Period. However, it would be safest to specify this timing in bonus plan documents or an employment agreement in order to avoid the inadvertent application of Section 409A if bonus payments are not made by this date. To the extent that a multi-year bonus plan or other arrangement provides for the payment of compensation beyond the Short Payment Period, it will be subject to the new rules. Also, to the extent that voluntary deferral plans allow the deferral of bonus amounts, it may be necessary to make sure the bonus plans comply with the definition of "performance based compensation" under the new rules to enable the deferral of bonuses six months before completion of the performance period.

Application to Employment Agreement

Section 409A may apply to many types of payments under an employment or consulting agreement. It is, thus, important to specify the timing of each type of payment to either exclude it from application of Section 409A as within the Short Payment Period or comply with Section 409A specified payment date requirements. The timing of severance payments may no longer be in the discretion of the employer. For public companies, employment agreements should address the application of the required six-month delay in severance payments to specified key employees. Application of the six-month delay requirement may be avoided by specifying payments to be made within the Short Payment Period or carving our "involuntary

severance." Amounts payable on "involuntary severance" or termination for "good reason" up to specified limits are exempt from Section 409A. Involuntary separation payments are limited to two times the lesser of total prior year compensation or two times the 401(a)(17) limit (e.g., $450,000 for 2007) paid within two years of termination. Final regulations clarify that even if severance is above this limit, amounts qualifying as involuntary severance (i.e., the first $450,000) may be carved out and thus paid within the first six months even if the six-month delay requirement is otherwise applicable. The continuation of most forms of benefits over the first two years after termination of employment or the payment of COBRA premiums will generally not be subject to Section 409A or may comply by specification of the payment schedule. Amounts payable on both voluntary and involuntary severance will generally be considered deferred compensation subject to the application of Section 409A. Since only one form of payment is permitted for a deferred compensation amount that is payable on termination of service, it is important that an employment agreement not specify a different form of termination payment based on the type of termination, e.g. voluntary, involuntary or for cause.

Equity-Based Compensation

Notice 2005-1 and proposed regulations make clear that the grant of a stock option, SAR, or other equity-based compensation may provide for deferral of compensation that is subject to the new rules subject to the following limitations:

(i) Stock Options: The grant of incentive stock options under Section 422 and the grant of an option under an employee stock purchase plan under Section 423 do not constitute deferrals of compensation under Section 409A. All other options to purchase stock of the service recipient will not constitute deferrals of compensation only if all of the following requirements are satisfied: (A) the exercise price is not and cannot become less than the "fair market value" of the underlying stock on the grant date (dividend rights will be considered a reduction in purchase price), (B) the optioned stock is "common stock" without preferences (other than on liquidation), (C) the optioned stock is stock of the service recipient or a 50% parent entity (or any entity up–not down–the 50% ownership chain and may be 20% if employee has business nexus to optioned company), not a subsidiary unless certain nexus requirements are met, and (D) the option does not include any feature for the deferral of compensation other than the deferral of recognition of income until the later of exercise or disposition of the option. For purposes of determining the fair market value of stock at the date of grant, the regulations include valuation rules which are likely to become very important. Public companies must base the exercise price on a reasonable valuation method using actual sales such as last sale, closing price or average price on day before or day of grant and may use an average over a specified period but only if the period is specified in advance and an irrevocable commitment to make grant precedes the valuation period. Private companies must use "reasonable application of reasonable valuation methods" based on factors such as asset values, anticipated cash flows, stock value of comparable entities, recent arm's length sales, and valuation methods used for other non-compensatory reasons. Regulations include safe harbors for (i) independent appraisals within prior 12 months, (ii) a repurchase formula generally applicable for compensatory and non-compensatory purposes that qualifies as fair market value under Section 83, or (iii) in the case of a start-up company, valuation of a "qualified individual" (five years experience in business valuation, appraisal, finance, investment banking, secured lending, etc.) applied at a time when no change of control (within 90 days) or public offering (within 180 days) is anticipated.

(ii) Stock Appreciation Rights: Proposed regulations provide that the grant of a SAR for the stock of the service recipient, like an option, does not constitute a deferral of compensation if the SAR exercise price is not less than the fair market value of the underlying stock on the date the right is granted, and the right does not include any feature for the deferral of compensation other than the deferral of recognition of income until the exercise of the right.

(iii) Restricted Property: Proposed regulations provide that there is no deferral of compensation if a service provider receives property merely because the value of the property is not includible in income (under Section 83) in the year of receipt by reason of the property being nontransferable and subject to a substantial risk of forfeiture, or is includible in income (under Section 83) solely

due to a valid election under Section 83(b). However, the new rules do apply to the receipt of a legally binding right to receive property (whether or not the property is restricted property) in a future year. Thus, restricted stock units or phantom stock will generally be subject to the new rules, while restricted stock will not (assuming the requirements prescribed above are satisfied).

(iv) Partnership Interests: Final regulations provide that while Section 409A will apply to compensation deferral arrangements between a partner and a partnership, until further guidance is issued, an issuance of or grant of an option to purchase a partnership interest in connection with the performance of services will be treated in the same manner as an issuance or option grant of stock.

Split Dollar Life Insurance

Final split dollar life insurance arrangements may be subject to Section 409A. Notice 2007-34 excludes from Section 409A collateral assignment split dollar arrangements treated as loans under final split dollar arrangements as long as they do not include any promise to forgive some or all of the loan in the future. Apparently the fact that the arrangement provides for an interest free loan where the foregone interest is imputed to the participant on an annual basis will not cause the arrangement to be subject to application of Section 409A absent a promise to forgive principle in the future. Notice 2007-34 also excludes the value of death benefits provided under an endorsement split dollar arrangement from Section 409A but provides that 409A would apply to any promise to transfer cash value in the future and may apply to guaranteed post retirement coverage. Presumably, non-equity collateral assignment arrangements will be treated the same under Section 409A as endorsement arrangements. Notice 2007-34 also attempts to provide guidance on the application of Section 409A to split dollar arrangements grandfathered under Notice 2002-8 and final split dollar regulations which became effective September 17, 2003. However, new guidance is not very clear. Notice 2007-34 is clear with respect to grandfathered arrangements, that modifications may be made, if necessary to bring an arrangement into compliance with Section 409A, without causing the arrangement to lose its grandfathered status under final split dollar regulations.

Likely Application to Tax-Exempt Organizations

Tax-exempt organizations are subject to special deferred compensation rules under Section 457. Section 457(b) eligible plans are specifically exempted and only Section 457(f) plans are subject to the new rules. Because Section 457(f) plans generally do not involve voluntary deferrals of compensation, they will not be subject to the new timing of deferral election rules. Also, Section 457(f) plans generally cliff vest benefits on retirement and do not offer any choices regarding the time and form of distribution nor any opportunity to accelerate distributions, except on death or disability. Thus the new rules limiting forms of distribution, acceleration and changes in distributions should not affect Section 457(f) plans significantly. Finally, many 457(f) plans may qualify for exemption from 409A by reason of the short term deferral rules since most 457(f) plans provide for payment at the time of vesting. However, the timing of “vesting” may be different under the new Section 409A definition of “substantial risk of forfeiture.” The Service has given notice of its intent to issue new regulations under Section 457 which apply Section 409A’s definition of “substantial risk of forfeiture” under 457(f). Thus, the new definition of “substantial risk of forfeiture” which excludes rolling risks of forfeiture and noncompete provisions, if applied to Section 457, may significantly impact Section 457(f) plans.

To the extent Section 409A is applicable to a 457(f) plan, the new rules are likely to require certain definitional changes such as the definition of “disability” under the plan. They may also require amendment of termination provisions which allow employers to liquidate the plan. Also, the new reporting requirements may apply to Section 457(f) plans. The new rules may also have adverse tax consequences for other plans sponsored by tax-exempt organizations that are not covered by Section 457(f), such as severance plans and split dollar arrangements discussed above.

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